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HAROLD B. WILLEY,

No. 204.

IN THE

Supreme Court of the United States

SOCIETY FOR SAVINGS IN THE CITY OF CLEVELAND,

Appellant,

vs.

JOHN W. PECK, TAX COMMISSIONER OF OHIO,

Appellee.

BRIEF FOR APPELLEE.

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BRIEF FOR APPELLEE.

THE QUESTION PRESENTED.

This case presents the question of whether a property tax levied by the state of Ohio against the ownership interests of the depositors in an incorporated mutual savings bank and measured by the value of the bank's surplus, reserves and undivided profits violates Article I, Section 8, Clause 2 or Article VI, Clause 2 of the Constitution of the United

States, or Section 3701, Revised Statutes (U.S.C. Title 31, Section 742), by taxing obligations of the United States.

STATEMENT OF FACTS.

The statement of facts in appellant's brief is accurate. In addition thereto it should be pointed out that the Ohio Statutes (Sections 5411-1, 5411-2, 5412, General Code) levy a tax against deposits in financial institutions. Such taxes, like the taxes on the ownership interests here in question, are assessed in the name of the financial institution. Deposit taxes were assessed against appellant for the years in question, were paid by it, and were expressly excluded from its application for refund. (R., 4; appellant's brief, p. 8.)

SUMMARY OF ARGUMENT.

The Supreme Court of Ohio held that the depositors in a mutual savings bank are the owners of the bank's surplus and reserves, and that such ownership represents a distinct taxable interest in property. It also held that when such a bank has accumulated from earnings a fund for distribution to its depositors, that fund is liable to assessment of a state tax levied on the ownership interests of the depositors, without regard to any federal securities held by the bank.

It is the contention of the Tax Commissioner that the Supreme Court of Ohio was correct for the following reasons:

1. A state is authorized to determine its own property law and to assess taxes against those forms of property which it chooses to tax.

2. The rule of *Van Allen v. Assessors*, 3 Wall., 573, permits a state to assess property taxes against the owners of interests in corporations at their full value regardless of any federal securities owned by the corporations.

3. Since the depositors in a mutual savings bank have a vested right to a distribution of the earnings on their deposits, any fund of such earnings which becomes available for distribution to the depositors can be made liable for the payment of property taxes levied against their ownership interests.

The Tax Commissioner also contends that the appellant bank cannot properly raise in this court the question of its right to reimburse itself from its depositors for taxes allegedly paid in their behalf, since no effort has been made by the bank to reimburse itself.

ARGUMENT.

I.

The Supreme Court of Ohio Interpreted the Tax in Question as a Tax Imposed Upon the Intangible Property Interests of Ownership of the Owners of the Corporation and Not as a Tax upon the Capital of or any Property Belonging to the Corporation. Hence, the Principle of the Bank Tax Case, 2 Wall., 200, Does not Apply Here.

Despite appellant's attempt to assert a contrary argument, the tax in question was *not* levied against any property of the bank. The Supreme Court of Ohio interpreted the taxing statutes as follows (161 Ohio St., 122 at 135-136; R., 41-42):

> "Our conclusion is that the words, 'capital employed, or the property representing it, in a financial institution the capital of which is not divided into shares, or which has no capital stock' as found in Section 5408, General Code, the words 'the value of the property representing the capital employed by such financial institution, not divided into shares' as found in Section 5412, General Code, and the words 'capital employed by financial institutions' as found in Section 5638-1, General Code, were intended by the General Assembly in each of those sections to describe the intangible property interests of ownership in a financial institution and not to describe the capital or any of the property of or belonging to such an institution. *It follows that, where a financial institution without capital divided into shares or without capital stock is a corporation, the General Assembly indicated an intent to impose a tax upon the intangible property interests of ownership of the owners of the corporation, and not a tax upon the capital of or any property of or belonging to the corporation.* The Society for Savings is such an incorporated financial institution." (Emphasis supplied.)

This same thought was carried into branches 8 and 9 of the syllabus (R., 31) which in Ohio represents the law of the case.

Because of this clear holding, the line of cases founded upon *Bank of Commerce v. New York City*, 2 Black, 620, and the *Bank Tax Case*, 2 Wall., 200, and discussed by appellant at pp. 10-13 of its brief are not applicable here. Nor is the case of *Farmers and Mechanics Savings Bank v. Minnesota*, 232 U. S., 516, applicable. Although that case involved a savings bank having no capital stock, it was specifically held by the state Supreme Court that the tax in question was levied against the surplus of *the bank*. (232 U. S., at 521.)

So the situation actually presented here is a unique one in which a state, for the first time, has recognized and purported to tax the ownership interests in a mutual savings bank.

II.

When a Tax is Levied Against the Ownership Interests of the Owners of a Corporation, it is Valid Without Regard to Federal Securities Held by the Corporation. That Principle, Based Upon Van Allen v. Assessors, 3 Wall., 573, is Applicable Here.

While a state may not levy a property tax on federal securities or on the capital of a corporation invested in such securities, it has been settled since the case of *Van Allen v. Assessors*, 3 Wall., 573, that a state may levy such a tax against the ownership interests of the owners of a corporation, even though all of the corporation's assets are federal securities. Other cases following this principle, and set out by Judge Taft in his opinion below are *National Bank*

v. Commonwealth, 9 Wall., 353, *Aberdeen Bank v. Chehalis County*, 166 U. S., 440, *Cleveland Trust Co. v. Lander*, 184 U. S., 111, and *Des Moines National Bank v. Fairweather, Mayor*, 263 U. S., 103.

It is the contention of the Tax Commissioner that the principle of the *Van Allen* case is applicable here. It is his contention that the primary consideration in a case of this sort is the property interest upon which the incidence of the tax falls. The state may recognize and tax a valid ownership interest in an ordinary corporation represented by a share of stock. It is the Tax Commissioner's contention that it may also recognize and tax such an interest in a mutual savings bank.

The appellant recognizes the principle of the *Van Allen* case but contends that it does not apply here for the reason that "the depositors in a mutual savings bank do not possess a property right * * * in the surplus or reserves of the bank * * * analogous to the property rights of stockholders." Furthermore, the appellant contends that since it cannot reimburse itself for the tax in question in the same manner as a corporation may reimburse itself from its shareholders, the tax must therefore fall as being improperly assessed against it. Those are questions which this Court must decide.

III.

The Appellant Cannot Contend in this Court that the Tax in Question is Improperly Assessed Against it, When it has Never Attempted, by Appropriate Action Under the State Law, to Reimburse Itself for the Tax Paid.

The appellant's whole case is built upon the contention that it cannot reimburse itself for the tax paid from the owners of the interests assessed, and that the tax must therefore fall as one assessed against appellant's own capital. But at the threshhold of this argument appellant is met by an obstacle which it has not attempted to gainsay: namely, that the appellant paid the tax in question voluntarily and has never attempted to reimburse itself from anyone except the state of Ohio.

Sections 5672, 5673, 5673-1 and 5673-2, General Code, are set out in the appendix to appellant's brief, and are referred to in Judge Taft's opinion (R., 42). They set out a statutory scheme whereby financial institutions may reimburse themselves on account of payment of taxes assessed upon deposits as taxable property of depositors and upon shares as taxable property of shareholders. It is true that they do not in so many words set out a statutory provision for reimbursement which specifically covers this case. But that is not the only thing to be considered.

No opportunity has ever been given the courts of Ohio to consider the question of reimbursement to appellant as it fits into the whole scheme of taxation. Until this case arose, the Supreme Court of Ohio had never spelled out the system of taxation of financial institutions in Ohio which taxed the ownership interests in banks like the appellant. It is not inconceivable that if called upon to do so, that

court would also hold that the right of reimbursement existed in favor of appellant against its depositors. The Ohio court might reach such a conclusion by its interpretation of the general scheme of taxation, "or under the general principle of law that one who pays the debt of another at his request can recover the amount from him." (See: *Home Savings Bank v. Des Moines*, 205 U. S., 503 at 518.)

Certain it is that state courts tend to interpret their own laws so as to assure their validity under the federal constitution. But appellant comes to this court contending that the Ohio law has only one construction—and that an unconstitutional one—although it has never asked the Ohio courts to construe their own state law. It is submitted that that is not a sound position for appellant to assume here, and that its appeal must be dismissed for the reason that it has not attempted to avail itself of its remedies under the state law.

IV.

Even if This Case Were Properly Before This Court, the Supreme Court of Ohio Was Correct in Holding That the Tax Was Paid by the Ownership Interests Assessed, and in Holding That No Reimbursement of the Corporation is Required in This Case.

A. The Depositors Do Have Separate Property Rights in the Surplus and Reserves of the Appellant.

Assuming that the appellant may now raise in this court the question of reimbursement which it did not raise below, we are brought to an argument upon which the appellant places great reliance: namely, that the taxation of ownership interests in the appellant is artificial and unsound. Appellant bases this argument upon the assertion that there are in fact no recognizable property interests subject to

taxation and that this is really just a disguised tax against the bank. At pp. 23-34 of its brief it makes such statements as: "The depositor does not own the property comprising the assets of the bank"; "his 'ownership interest' is limited to his deposits and distributions of earnings * * * which may be authorized by the * * * trustees"; "The depositor has no interest or property right * * * separate and apart from his deposit"; "The depositors have no interest * * * by which they can compel distribution;" "When a depositor withdraws his deposit, any possible interest that he might have in the bank's surplus is terminated."

It is submitted that these statements are not sound in view of the property concepts which govern mutual savings societies. It has consistently been held that the relationship between the trustees and depositors of such institutions is one of trust, not of debtor and creditor, and that the trustees have a right to accumulate only such reserves as are required by statute or by a sound discretion for the purpose of protecting the deposits. The depositors have a vested right in the remainder. They have an interest in the continuity of the enterprise strong enough to enable them to maintain a bill in equity to restrain its dissolution. (*Barrett v. Bloomfield Savings Institution*, 64 N. J. Eq., 425, 54 Atl., 543, affirmed 66 N. J. Eq., 431, 57 Atl., 1131.)

These principles and the leading cases applying them were discussed by Judge Taft in his opinion below. (R., 43-45.) The attention of the court is especially directed to the cases of *Worcester County Institution for Savings v. City of Worcester*, 10 Cush. (Mass.) 128, and *Providence Institution for Savings v. Gardner*, 4 R. I., 484 (R., 45). Those were early cases holding that property in which a savings institution had invested funds could *not* be taxed as property *of the bank*, and inferring that it was properly

taxable to the depositors. In addition, attention is directed to a decision of this court set out in *Savings Bank of Danbury v. Loewe*, 242 U. S., 357. The question there before the court was whether an attachment of a savings bank account carried with it dividends which accrued after the writ of attachment was served. In holding that it did, this court used the following language (242 U. S., 357 at 358-360):

> "* * * If the right is vested the attachment reaches the whole of it, and therefore * * * it was admitted at the argument that in the case of an interest-bearing debt the subsequently accruing interest was held as well as the principal. * * * It may be true that apart from statute the attachment of stock in a corporation would not hold subsequently declared dividends, but, if so, that is because the stockholders have no right to the dividends until they are declared, which may never be if the directors see fit to convert earnings into capital. (Citations) The question then narrows itself to whether the so-called dividends of savings banks are analogous to dividends of a corporation or to interest due by contract upon a debt.
>
> "The plaintiff in error is an ordinary savings bank without stockholders. It is subject to a fiduciary duty to hold and invest for the benefit of its depositors all the funds that it receives and to pay over to them all the net income earned * * * [the depositor] has a vested right to the dividends, a vested right that the corporation should take the most prudent steps to secure them, with *an identified fund* devoted to the result. We do not perceive why the possibility of there being no earnings * * * or a possibility of the earnings being greater than was expected, should make the right less a present one, subject to and covered by the attachment * * *." (Emphasis supplied.)

It should also be pointed out that the statute under which appellant is organized, Section 710-148d, General Code (See: Stipulation, R., 6), specifically provides that "Invest-

ments (of deposits) may be made * * * and the income of profits thereof *shall* be applied and divided among the persons making deposits," and that appellant is a true savings bank.

B. The Property Rights of the Depositors Are Subject to Taxation by Assessing the Fund Which is Available For the Payment of Dividends.

Assuming that the depositors do have definable property rights in the surplus and reserves of the appellant, how is the state to reach those interests for the purpose of assessing its taxes without running afoul of the decisions of this Court? The appellant contends that it cannot be done, saying that any reduction of the earnings fund is an assessment against the bank. The Tax Commissioner contends that because of the nature of appellant's enterprise he can assess the tax in question, *against any earnings available to the depositors for distribution*, whenever such earnings exist. (The Supreme Court of Ohio limited the collection of the tax to the availability of such a fund. See branch 7 of the syllabus, R., 31.)

At the beginning of this argument attention should be directed to a matter which appellant apparently misapprehends concerning its own organization. The governing statute, Section 710-148b, General Code (R., 6), clearly provides that "The incorporators * * * shall have the powers provided in section 8623-99, General Code," (corporations not for profit) and that "So far as consistent with this act, all provisions * * * relating to corporations *not for profit* shall apply * * * hereunder." Appellant insists upon drawing analogies and citing cases dealing with corporations for profit having shares of stock. It is submitted that such precedents are not applicable here.

In keeping with its reliance upon shares of stock, appellant also insists that the rule of *Van Allen v. Assessors*, 3 Wall., 573, is applicable only when the ownership interests being taxed are represented by shares in a corporation for profit. It is submitted, however, that the underlying basis of the *Van Allen* case is a recognition of *property* rights, and that the property rules announced were applied to taxation of shares of stock because that was the question before the court. We now are confronted with a question of proper taxation of other interests.

It so happens that the rules of taxation which have grown out of the *Van Allen* case, and from cases such as *National Bank v. Commonwealth*, 9 Wall., 353, which authorize assessment of shares against the corporation with a right of reimbursement, are particularly suited to taxation of the separate property in corporate shares. The shares are easily definable and are transferable. *They have no vested right in any distributions from the corporation.* It is only right that taxes levied against them should be restored to the corporation; and it is not accurate to say that an assessment against funds in the hands of the corporation reduces their value proportionately. (Cf: *Home Savings Bank v. Des Moines*, 205 U. S., 503.) But there is nothing God-given about such a scheme of taxation, nor is it the only one that can be applied when the object of taxation is a completely different set of property interests.

In the case now before this court the property interests are *not* easily definable and they are *not* withdrawable or transferable. *But they do have a vested right in earnings of the corporation.* And it *is* accurate to say that an assessment against funds in the hands of the corporation available for distribution does proportionately reduce the amount of each property interest. Therein lies the distinc-

tion from the cases relied on by the appellant. There is the justification for the holding of the Supreme Court of Ohio; and there is the answer to the question before this Court of whether Ohio properly applied the rationale of the *Van Allen* case to the taxation of the ownership interests in the appellant.

CONCLUSION.

The parties here are contesting whether certain tax money shall go to the state of Ohio or to the appellant. In all cases of this sort this court has consistently said that its concern is with the Constitutional and statutory immunity of federal obligations from state taxation. The *Bank of Commerce* case and the *Bank Tax* case were designed to extend the protection of *Weston v. City of Charleston*, 2 Peters, 449, to direct assessments against corporate capital. The rule of the *Van Allen* case was designed to allow the states to assess separate property interests where they exist. Assuming that separate property interests do exist in this case, the appellant has not shown that the taxation of such interests creates any more of a burden on Federal obligations than does the taxation of shares of stock, so long sanctioned by this Court. Rather, appellant has sought by a catatorical denial of the existence of a property right and by a slavish insistence upon a certain form of payment, to receive for itself a tax windfall which has no relation to the protection of the federal securities involved.

Many of the property questions in this case are almost academic. Most of appellant's depositors do not know that they belong to a society which must divide its profits or that they are obligated to share in the losses if the society falls on evil days. Since their deposits are insured they

will never have to face that latter possibility. But those facts do not transform the nature of appellant's business organization nor prevent the Supreme Court of Ohio from correctly defining the property interests. It cannot properly be said here that the Ohio court created fictitious interests in order to avoid the decisions of this court, and that is the only real federal question in the case. Since it did not, the matter is simply one for the application of the rule of the *Van Allen* case.

It is therefore submitted that the decision of the Supreme Court of Ohio was correct, and that appellant's appeal should be dismissed or the decision of the lower court affirmed.

Respectfully submitted,

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